

Comments on Monetary Policy

(With Praise for Urban Lehner, Norman Borlaug and Dentists)

Remarks before the DTN/The Progressive Farmer Ag Summit 2013



Richard W. Fisher
President and CEO
Federal Reserve Bank of Dallas

Chicago
December 9, 2013

The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

Comments on Monetary Policy

(With Praise for Urban Lehner, Norman Borlaug and Dentists)

Richard W. Fisher

Thank you, Urban (Lehner).

I lived in Tokyo for much of 1990, when Urban was bureau chief of the *Wall Street Journal* there. He taught me Japan, steering me away from then-stereotypical views harbored by American analysts and guiding me through a deep dive into Japanese literature and history that later served me well when I was deputy U.S. trade representative and negotiated with the Japanese. Only Urban Lehner could have authored a masterpiece like “Let’s Talk Turkey About Japanese Turkeys and Other Tales...”¹ His deep understanding of the uniqueness of Japan is impressive, as is his work the past decade as a discerning editor of *DTN/The Progressive Farmer*. Thank you, Urban, for your friendship and insights.

In Praise of Norman Borlaug

You might wonder why I so readily accepted Urban’s invitation to speak to this great group of farm and agriculture leaders on a cold December day. Typically, I and my colleagues on the Federal Open Market Committee (FOMC) defer to my respected colleague, Esther George, the president of the Kansas City Fed, and her able staff for commentary on developments in agriculture. I promise the rapidity of my acceptance of Urban’s invitation to speak to you has little to do with my eagerness to see the Dallas Cowboys manhandle the Bears tonight at Soldier Field. But my link to you and to agriculture actually does come from sports: from Little League baseball rather than NFL football.

As Urban mentioned, I grew up in Mexico City. I played Little League there for the Leones (the Lions). My coach was Norman Borlaug. I doubt there is a person in this room who doesn’t know and revere that name. Back in 1970, when the Nobel committee awarded the Peace Prize based on proven success and true merit, I believe their citation provided the best summary of Norman Borlaug’s contribution to mankind: “More than any other single person of this age,” the Nobel committee declared, “he has helped provide bread for a hungry world” with his development of genetically unique strains of “semi-dwarf” wheat.² I don’t think one can overstate what Norman Borlaug’s “green revolution” accomplished: He saved billions of people from starvation by applying science to agriculture.

Borlaug developed those wheat strains working in Mexico with a grant from the Rockefeller Foundation. When he wasn't in the lab or out in the field, or letting his son Billy and me ride with him on his tractor, he coached me in Mexico City's Little League.

I stayed in close touch over the years with the Borlaugs and often spoke of my coach at our family dinner table. One year, he came to my daughter Alison's school, Hockaday in Dallas, to speak at a lower-school assembly. The headmistress began by asking if any of the girls knew why Mr. Borlaug received the Nobel Peace Prize. Alison's hand shot up. She thought it was "for coaching Little League baseball."

Norman Borlaug died on Sept. 12, 2009. That very day, another of our little cadre of gringos who grew up in Mexico City, Professor Bill Raun of Oklahoma State University, was visiting his idol and showing him the latest version of a handheld device he had developed called the GreenSeeker. The sensor could be used by any farmer in the field to easily determine how much fertilizer and nitrogen to properly apply.³ Borlaug approved. In fact, the very last words he uttered before passing away were "Take it to the farmer."

I am honored that you have given me the chance to "take it to the farmer" by speaking here today.

In Ag, the Cure for High Prices Is ... High Prices

Before joining the Fed, as mentioned by Urban, I spent four years as deputy U.S. trade representative and countless hours trying to settle vexing ag trade disputes not only with the Japanese but with many other countries. So if you permit me to nostalgically stray from my current role as a central banker, I am going to take the liberty of speaking briefly to recent developments in agriculture before providing my personal perspective on the outlook for the economy and monetary policy.

We are seeing a significant and sustained correction in the price of wheat and corn. I expect soybeans to follow, as well as the sources of animal protein created from these basic plant-food stocks. We have had bumper crops of wheat and corn and huge plantings of soy. When I say "we," I am referring not just to the United States but to what I call the globalized breadbasket, which consists of the United States, the Black Sea area, Canada, Australia, Latin America and other growing areas that have responded with prodigious output to high prices that prevailed for a sustained period. These are elevated prices that have popularly been attributed to surging demand from China and others that have moved up the protein ladder as they have achieved greater prosperity in the post-Cold War, post-Mao Zedong world.

From an economic standpoint, there are lessons to be learned here. First, the farmer's rule of thumb on price movements still obtains: The cure for high prices is high prices. As night follows day, farmers, aided today by successive iterations of Norman Borlaug's innovations and new, easy-to-use technological achievements like Bill Raun's, will respond to demand-pull inflation in crop prices with greater plantings and harvests, often to the point of overshooting. This is no doubt a phenomenon you will be pursuing at this summit on "Tactics to Tame Volatility."

As you consider potential tactics, I hope you will keep the following in mind:

- a) Free trade is essential for farmers everywhere. Protectionism is the surest path to economic hell. We want a global breadbasket, and we want U.S. farmers and all those interests in the U.S. who make it possible to till fields everywhere—from our great machinery makers to our fertilizer and agribusiness firms—to be able to compete in every market worldwide as well as with foreign companies in our own market. Competition sharpens wits and strengthens muscles. In an openly competitive world, I have no doubt our producers and companies will continually outperform others.

- b) It is important that Borlaug's revolution of genetic modification be responsibly carried forward. Otherwise, the freer-trade regime that has been achieved can be threatened. Or be exploited so as to instill protectionism. I am thinking particularly of the current situation of the millions of tons of corn currently sitting off China's shores, held out of the Chinese market ostensibly because of its GMO (genetically modified organism) characteristics, despite its acceptance in other major markets, including our own. I have no desire to enter into any argument with greens and environmentalists; I simply wish to suggest that you might consider ways to reach internationally agreed-upon standards for GMO enhancement.

I would add a "c," a third point for you to bear in mind: You had all better use to the good this unusual period in economic history of proactively accommodative monetary policy by the Federal Reserve and other major central banks. The FOMC has made money the cheapest and most widely available of any time in American history. Interest rates dipped to their lowest level in 237 years; bond and stock markets rallied to historic highs in both nominal and real terms; bankers and investors are flush with liquidity; for anybody who is creditworthy, money is über-abundant. This will not last forever. One would be foolish not to exploit it now.

The Course of Monetary Policy

In discussing the course of monetary policy, I can only speak to my own views.

As Urban mentioned, I will be a voter on the FOMC next year. I am happy to lay out for you my perspective. It is this: In my view, the Federal Reserve has supplied more than sufficient liquidity to fuel economic recovery above and beyond a reduction of unemployment from its current level of 7 percent. As I just said, money is cheap and liquidity is abundant. Indeed, it is coursing over the gunwales of the ship of our economy, placing us at risk of becoming submerged in financial shenanigans rather than in conducting business based on fundamentals.

Monetary Policy Rendered Flaccid

To be sure, the job creators in our economy—private companies—have used this period of accommodative monetary policy to clean up the liability side of their balance sheets and fine-tune their bottom lines by buying shares and increasing dividends. They have also continued achieving productivity enhancement and relentless reduction in SG&A (selling, general and administrative expenses). Running tight ships, they are now poised to hire as they become more confident about nonmonetary matters that remain unresolved.

I used to say that the United States was the best-looking horse in the global glue factory. Now, I firmly believe we are the most fit stallion or filly on the global racetrack: Our companies are the most financially prepared and most productively operated they have been at any time during the nearly four decades since I graduated from business school. What is holding them back is not the cost or the availability of credit and finance. What is holding them back is fiscal and regulatory policy that is, at best, uncertain, and at worst, counterproductive.

Against that background, I believe that the current program of purchasing \$85 billion per month in U.S. Treasuries and mortgage-backed securities comes at a cost that far exceeds its purported benefits. Presently, there is no private or public company that I know of, including many CCC-rated credits, that does not now have access to sufficient, cheap capital. There is no private or public company I know of that considers monetary policy to be deficient. Instead, to a company, every CEO I talk to feels that uncertainty derived from fiscal policy and regulatory interference is the key government-induced deterrent to more robust economic growth and profitability.

The FOMC has helped enable a sharp turn in the housing market and roaring stock and bond markets. I would argue that the former benefited the middle-income quartiles, while

the latter has primarily benefited the rich and the quick. Though the recent numbers are encouraging, easy money has failed to encourage the robust payroll expansion that is the basis for the sustained consumer demand on which our economy depends. It cannot do so in and of itself. Without fiscal policy that incentivizes rather than discourages U.S. capex (capital expenditure), this accommodative monetary policy aimed at reducing unemployment (especially structural unemployment) or improving the quality of jobs is rendered flaccid and less than optimally effective. And as to the housing markets, prices are now appreciating to levels that may be hampering affordability in many markets.

What About Inflation?

As to the issue of inflation, the run rate for personal consumption expenditure (PCE) prices in the third quarter was 2 percent, according to recently revised data. The Dallas Fed computes a Trimmed Mean analysis of the PCE, which we feel provides a more accurate view of inflationary developments. The 12-month run rate for the Trimmed Mean PCE has been steady at 1.3 percent for the past seven months.

As measured by surveys and financial market indicators, expected inflation five or more years out is anchored firmly at levels consistent with the 2 percent rate that modern central bankers now cotton to as appropriate. These surveys and indicators also show expected price increases over 2014 only modestly below 2 percent.

Against this background, I am not of the school of thought that monetary policy need continue to be hyperaccommodative or be made even more so in order to bring medium-term inflation expectations closer to target. I certainly don't see any justification for seeking to raise medium-term expectations above 2 percent as an inducement for businesses to pour on capex and expand payrolls or for policy to act as an incentive for consumers to go out and spend more money now rather than later. To me, this would just undermine the slowly improving confidence we have begun to see.

Especially given that we have a surfeit of excess liquidity sloshing about in the system, the idea of ramping up inflation expectations from their current tame levels strikes me as short-sighted and even reckless. We already have enough kindling for potential long-term inflation, which will sorely test our capacity to manage policy going forward. I do not wish to add further wood to that pile.

It Is Time to Taper

In my view, we at the Fed should begin tapering back our bond purchases at the earliest opportunity. To enable the markets to digest this change of course with minimal disruption, we should do so within the context of a clearly articulated, well-defined calendar for reducing purchases on a steady path to zero. We should make clear that, barring some serious economic crisis, we will stay the course of reduction rather than give an imprecise nod as we did after the May and June meetings that led markets to believe the program might end as unemployment reached 7 percent.

Only then can we at the Fed return to focusing on management of the overnight rate that anchors the yield curve. To be sure, we may wish to keep overnight rates low for a prolonged period, depending on economic developments. But we need to return to conducting monetary policy that is more in keeping with the normal role of a central bank. We need to break away from trying to manipulate term premia and stop prolonging the distortions that accrue from our massive long-term bond purchases and the risks we incur in building an ever-expanding balance sheet that is now approaching \$4 trillion.

Becoming Dentists Once Again

I consider this strategy desirable on its own merit: I would feel more comfortable were we to remove ourselves as soon as possible from interfering with the normal price-setting functioning of financial markets. And I consider it desirable from the standpoint of protecting our limited franchise. As Chairman (Ben) Bernanke has pointed out politely, and I have argued less diplomatically, good monetary policy is necessary—but certainly not sufficient—to return the nation to full employment. Acting as though we can go it alone only builds expectations that far exceed our capacity. And it could lead us to believe that we have a greater capacity to control economic outcomes than we actually have.

If I may paraphrase a sainted figure for many of my colleagues, John Maynard Keynes: If the members of the FOMC could manage to get themselves to once again be thought of as humble, competent people on the level of dentists, that would be splendid.⁴ I would argue that the time to reassume a more humble central banker persona is upon us.

That, Urban, is my take on monetary policy in a nutshell. Now, in the best tradition of central banking—and dentistry! —I would be happy to avoid answering any questions you or your colleagues might have.

Thank you.

Notes

¹ See *Let's Talk Turkey (About Japanese Turkeys): And Other Tales from the Asian Wall Street Journal*, Urban C. Lehner, ed., Rutland, Vt.: Charles E. Tuttle Co, 1997.

² See www.nobelprize.org/nobel_prizes/peace/laureates/1970/borlaug-facts.html for more information on Norman Borlaug's 1970 Nobel Prize.

³ See www.nue.okstate.edu/ to learn more about how Dr. Bill Raun took his GreenSeeker to the farmers.

⁴ The original quote can be found as the final sentence of his essay "The Future," by John M. Keynes, in *Essays in Persuasion*, Chapter 5, London: Macmillan and Co., 1931.